IN THE

Supreme Court of the United States.

OCTOBER TERM, 1936.

GUY S. MARTIN,
Petitioner,

v.

NATIONAL SURETY COMPANY, a Corporation, et al.,
Respondents.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

OPINIONS OF THE COURTS BELOW.

The District Court filed no opinion in the case. The opinion of the Circuit Court of Appeals for the Eighth Circuit is not yet officially reported, but it is reported at 85 F. (2d) 135, and is printed in full in the record, beginning at page 154. It was rendered on August 12, 1936.

II.

JURISDICTION.

(a) Petition for certiorari is filed upon authority of Judicial Code, Section 240, as amended (28 U. S. C., Sec.

347a), which gives this Court jurisdiction to review any judgment or decree of a United States Circuit Court of Appeals.

(b) The date when the judgment became final was August 17, 1936, when the decree of affirmance was entered (R. 162).

(c) Respondent National Surety Company in the District Court sought and obtained a decree requiring the payment into court by petitioner of money collected at the instance of the contractor under a United States Government construction contract and which petitioner had sought to apply to an indebtedness due from the contractor (Decrees filed February 23, 1933, and May 2, 1933; R. 17, 30). Thereafter the funds which were deposited pursuant to such decrees were ordered disbursed to certain creditors who had furnished material and labor to the contractor and who had been allowed to file claims, and petitioner's claim was disallowed (decree filed November 26, 1934; R. 49-54). This latter decree was the final decree in the District Court and was appealed by petitioner to the Circuit Court of Appeals for the Eighth Circuit, by which it was affirmed (R. 162).

(d) Cases believed to sustain the jurisdiction of this Court to review the decision of the Court of Appeals are:

Magnum Import Co. v. Houbigant, Inc., 262 U. S. 159;
Columbus Watch Co. v. Robbins, 148 U. S. 266;
Henningsen v. U. S. Fidelity & Guaranty Co., 268 U. S. 404.

III.

STATEMENT OF THE CASE.

As a statement containing all that is deemed material to the consideration of the questions presented has been given in the petition, it will not be repeated here.

IV.

SPECIFICATION OF ERRORS.

1. The Circuit Court of Appeals erred in holding that money caused to be repaid to the lender by a contractor on a United States Government contract out of progress payments was subject, in the hands of the lender, to an equitable lien in favor of materialmen and laborers, requiring the lender to turn over the money to materialmen and laborers as the creditors entitled thereto.

2. The Court of Appeals, in failing to reverse the District Court in its finding that petitioner was a partner of the contractor and therefore that he was liable for labor and material claims and that his claim was subject thereto, erred for the reasons recited in paragraph IIa of Section B of the petition for the writ.

3. The Court of Appeals, in failing to reverse the District Court in its findings that the execution of the power of attorney to petitioner and his collection of the funds due for completed work constituted a fraud upon the materialmen and laborers, erred for the reasons recited in paragraph IIb of Section B of the petition for the writ.

4. The Court of Appeals, in failing to reverse the District Court in its finding that the claim filed by petitioner included items advanced on the Havana contract, and in concluding therefrom that petitioner did not come into equity "with clean hands," erred for the reasons stated in paragraph II c of Section B of the petition for the writ.

V.

ARGUMENT.

Summary of Argument.

A.

Where a contractor under a United States Government contract has caused money due on *progress payments* to be collected and to be repaid to one from whom he had borrowed, the money in the hands of the lender is not subject to any lien in favor of unpaid materialmen and laborers requiring its payment to them as the creditors entitled thereto. In holding the contrary, the Court of Appeals is in conflict with decisions of other Courts of Appeals.

B.

The decisions which have not passed upon this precise question, but which declare a lien or superior equities in favor of sureties or of labor and material creditors on public works contracts, have involved either (1) retained percentages only or (2) other funds due but still retained and unpaid. Such cases, while not specifically controlling or analogous, are applicable in principle and the decision of the Court of Appeals here is in conflict therewith.

C.

Evidence that in connection with an earlier contract the contractor had arranged to borrow money from petitioner and to divide profits with him did not subject petitioner to the liability of a partner on the Carlinville contract, which had not then been obtained. Even if such arrangement existed and was extended to the later contract no partnership in any sense was created thereby.

D.

In accepting a power of attorney from the contractor and in collecting the funds due for completed work in order to repay an existing indebtedness, petitioner was entirely within his rights and such actions constituted no fraud whatever upon either the surety on the bond or the creditors secured thereby. No implication of fraud arises from the fact that petitioner formerly had been an agent of the surety, and as such had executed the bond, for it was his vigilance alone, and not any confidential information received as agent, which prompted the subsequent action to protect his own interests.

E.

No basis whatever appears for an assertion that in the claim filed by petitioner, pursuant to the District Court's order, there was misrepresentation as to the items covered by such claim and that therefore he "did not come into equity with clean hands."

Argument.

Points A and B.

The contention of the petitioner that the money caused to be repaid to him out of progress payments collected at the instance of the contractor was not, in his hands, subject to an equitable lien requiring that it be turned over to unpaid laborers and materialmen, is fully sustained by the following decisions, with all of which the opinion of the Court of Appeals conflicts:

Kane v. First Nat. Bank (C. C. A. 5), 56 F. (2d) 534 (cert. denied 290 U. S. 667);

Third Nat. Bank v. Detroit Fidelity & Surety Co. (C. C. A. 5), 65 F. (2d) 548 (cert. denied 290 U. S. 667);

Maryland Casualty Co. v. Board of Water Comm'rs (C. C. A. 2), 66 F. (2d) 730 (cert. denied 290 U. S. 702);

Fidelity & Deposit Co. v. Union State Bank (D. C. Minn.), 21 F. (2d) 102.

It may be observed at the outset that neither the surety nor those whose claims it secured possessed any rights under the purported assignment to it of payments becoming due the contractor (R. 91). The District Court in this regard erred in its conclusion (R. 29, par. 7) that by reason of this assignment the surety was entitled to have the progress payments collected by Martin available for the payment of bills, but the Court of Appeals correctly held (R. 159) that such assignment was void because of the provisions of 31 U. S. C., Sec. 203, and that therefore the surety had no title to the money. (See London & Lancashire Indemnity Co. v. Endres (C. C. A. 8), 290 F. 98; Spofford v. Kirk, 97 U. S. 484; National Bank of Commerce v. Downie, 218 U. S. 345.) The discussion here thus is narrowed to one of equitable rights and of cases in which that issue alone is involved.

In the *Maryland Casualty Co.* case the contractor had defaulted on his contract and the surety had been required to complete it. Although holding that funds unpaid at the time of the default should be used for the benefit of the surety, the Court recognized the superior right of a bank, which had loaned money for the work, to receive and apply to the debt of the contractor payments made prior to the default (66 F. [2d], l. c 738-739).

In the *Fidelity & Deposit Co.* case it was expressly ruled that payments received by the contractor during the

progress of the work belong to him unconditionally and unimpaired by any lien or equitable right to which the surety might be subrogated.

In *Kane v. First National Bank* the appellate court passed squarely upon the question here involved, saying (56 F. [2d], at page 535):

> "Money or checks paid to him as the work progresses are the property of the contractor unincumbered by any trust, just as are payments to others for goods manufactured or services performed. The contractor's banker may receive such checks and is not bound to see to their application, *nor to ascertain the state of the contractor's account with each contract; nor, if he knows it, need he govern himself in anywise with reference thereto.*" (Emphasis ours.)

The same Court, in the *Third National Bank* case reaffirmed the proposition that installment payments are by the contract left free that the contractor may use them in getting either material or labor. It is pointed out that whether he uses such payments to pay claims directly, or to repay one who temporarily advances the money for that purpose, "he does what is expected and that to which the surety has no right to object" (65 F. [2d], l. c. 550).

The unsatisfactory results of a rule contrary to the doctrine of these cases are obvious. Suppose a contractor incurs a hotel bill, a tailor bill or a bill for some other necessity or luxury, and tenders in payment money which his creditor knows came from the performance of a public works contract. Must the creditor refuse it, or take it clothed with an equity that, perchance, later permits it to be taken away from him for the payment of those who furnished labor or material under the contract? If so, it can only be said that no one outside a special class of

creditors may deal with such a contractor and look for financial satisfaction with certainty.

Without such undue regard for the rights of laborers and materialmen, they have the security afforded by the bond and also by the amounts expressly reserved for their protection, which security is not provided even to one, such as petitioner, who advances money that material and labor bills may be paid during the progress of the work. Should their rights be extended as here proposed, the lender is deprived of every prospect of reimbursement where the contractor's resources are limited. It is believed that the decisions of this Court, as well as those others which have recognized a lien in favor of laborers and materialmen in certain contract payments (or in favor of sureties by right of subrogation), furnish no support for such a theory, but, rather, refute it. Reference is made to:

Prairie State Nat. Bank v. United States, 164 U. S. 227;

Henningsen v. U. S. Fidelity & Guaranty Co., 208 U. S. 404;

American Surety Co. v. Westinghouse Mfg. Co., 396 U. S. 133, affirming 75 F. (2d) 377 (C. C. A. 5);

Claiborne Parish School Bd. v. Fidelity & Deposit Co. (C. C. A. 5), 40 F. (2d) 577;

Pratt Lumber Co. v. Gill Co. (D. C. N. Car.), 278 F. 783;

Fidelity & Deposit Co. v. City of Auburn (Wash.), 272 Pac. 34;

Massachusetts Bonding & Ins. Co. v. Ripley County Bank, 208 Mo. App. 560, 237 S. W. 182;

U. S. Fidelity & Guaranty Co. v. Sweeney (C. C. A. 8), 80 F. (2d) 235;

Riverview State Bank v. Wentz (C. C. A. 8), 34 F. (2d) 419;

Exchange State Bank v. Federal Surety Co. (C. C. A. 8), 28 F. (2d) 485;
Farmers' Bank v. Hayes (C. C. A. 6), 58 F. (2d) 32;
Lacy v. Maryland Casualty Co. (C. C. A. 4), 32 F. (2d) 48;
Belknap Hardware Mfg. Co. v. Ohio River Contract Co. (C. C. A. 6), 271 F. 144.

Only in the four cases last cited were the equitable rights of sureties, who had paid material and labor claims, extended to both retained percentages and current estimates. In all four the contractors had defaulted their contracts and the work had been completed by the sureties (or, as in the *Belknap* case, by a receiver for the contractor). In all four, the funds held subject to lien remained unpaid, and in none was the lien extended to current estimates paid over to the contractor prior to his abandonment of the contract. For these reasons such cases lend no support to the decision here.

In the *Prairie Bank* case, the reasoning of this Court appears clearly to have been that the percentage to be retained by the United States until completion of the work constituted a *security* for the performance of the contract. It was the Government's right in that *security* to which the surety became subrogated upon fulfilling the contractor's obligation. As pointed out by the Court of Appeals for the Fifth Circuit: "The case has no application to money not reserved as a security but paid over to the contractor" [Kane v. First National Bank, 56 F. (2d) 534, at page 536].

While in the *Henningsen* case, as the court below points out (R. 161), the identity of the rights to which the surety was held subrogated upon payment of material and labor claims was not made entirely clear, the fact remains that

it was a balance remaining due and unpaid to which its rights attached. Moreover, this Court merely followed the decision in the Prairie Bank case, thus in effect reiterating the thought that the rights in the fund had their existence *because of the character of that fund as a security for performance and for payment of claims.*

Again, in *American Surety Co. v. Westinghouse Electric Mfg. Co.* (C. C. A. 5), 75 F. (2d) 377, affirmed at 296 U. S. 133, only the retained percentage was involved in the determination of equities as between laborers and materialmen and the surety.

It is thus seen that none of the decisions which have been discussed extends the rights either of a surety or of materialmen and laborers beyond the funds specifically reserved as security or those due and not paid over at the time of the assertion of such rights. Neither do any of the other decisions which might be cited. For the first time, in this case, it has been held that installment payments, though left free by the contract, yet are encumbered.

It has not been deemed sufficient that one class of creditors shall have the protection of a bond and the added security of funds reserved for their benefit. They have here been given further prior rights, but at the expense of one who, instead of labor or material, furnished money for the purchase of labor and material.

To thus increase the lender's risk is to increase inequality of rights.

The consequences of this decision, if not reversed, are apparent. No bank or other lender could with safety render a public works contractor financial assistance. Knowing that money to be collected on the contract and repaid may be subject to a prior encumbrance, will a

lender give such assistance? Will not many contractors be deprived of an opportunity to bid on public works, because of their inability to obtain financing? Will not the governments—federal, state and municipal—all be losers through lessened competition and increased costs? It would seem that these predictable results alone are reason enough for declining to add to the protection already given those who furnish labor and materials for these contracts.

It is urged that the decision sought to be reviewed and reversed is supported by neither authority nor reason nor considerations of policy. It is opposed by all three.

POINT C.

Passed without decision by the Court of Appeals was the ruling of the District Court that petitioner was a partner of the contractor and therefore was liable for material and labor claims and could not assert a claim superior thereto (R. 47).

This ruling was based upon the uncorroborated testimony of the contractor given at a time when he was endeavoring to support a claim to the fund adverse to that of Martin (R. 137-139), which claim on behalf of Edward Tobin, Sr., was found by the Court to be without substance and to have been collusively filed (R. 46). The effect of that testimony was merely that on an earlier contract the contractor had arranged to borrow money from Martin and to divide profits with him, and that such arrangement had "carried through the Carlinville job." At the same time he admitted that when the arrangement was made it was not understood to apply to the Carlinville contract, "because we did not have but the one job at the time" (R. 139).

It is not believed that this constituted proof of an agreement to divide anticipated profits on the Carlinville contract, but even construing it as such it falls far short of evidence of a partnership or of any other relationship, indeed, than that of borrower and lender.

As pointed out in *Meehan v. Valentine*, 145 U. S. 611, at page 624, it is now well settled that a lender of money is not a partner in any sense, even though he is to receive a part of the profits "in lieu of or in addition to interest." Cases not adhering to this rule are there distinguished by the statement that, "The person held liable as a partner furnished the whole capital on which the business was carried on by another, or else contributed part of the capital and took an active part in the management of the business."

Authorities in accord include: Annot. 18 L. R. A. (N. S.) 1055; 33 C. J. 847; Randle v. Barnard, 26 C. C. A. (7) 568, 81 F. 682; Darling v. Buddy, 318 Mo. 784; Darling v. Potts, 118 Mo. 506; Schumann-Heink v. Folsom, 328 Ill. 321.

POINT D.

Other reasons assigned by the District Court in ruling against petitioner's claim to the fund which are deemed material to this discussion but were not passed upon by the Court of Appeals were those stated in paragraphs VII-B and VII-C of the "Findings of Fact" (R. 47-48). It is there held that Martin, having written the bond as agent of the surety, "occupied the position of having notice and knowledge of the situation confronting Tobin, a notice and knowledge which neither the surety company nor the creditors of Tobin could have," and, further, that the execution of the power of attorney to Martin and

his collection of the funds due for completed work constituted a fraud upon the other creditors and the surety.

Neither the finding that Martin occupied a position giving him information not possessed by the others, nor the conclusion as to fraud apparently based thereon, can find support in the facts or the law applicable thereto.

Not only did Martin satisfactorily explain his reasons for executing the bond contrary to the advice of a vice-president of the surety (R. 114). It was affirmatively shown by the surety that it first learned of unpaid claims as early as October, 1932 (R. 84), but that Martin was not apprised of the situation until December, 1932, or later (R. 81, 82, 83, 95). It therefore cannot be said that petitioner's knowledge of approaching financial difficulties was superior or even equal to that of the surety, whose employes had checked up on outstanding bills as the work progressed (R. 82, 85), nor to that of the creditors themselves whose bills remained unpaid after presentation. Moreover, the actions which petitioner took for his own protection took place subsequent to the termination of his agency with the surety, and, in addition, they were wholly independent of and unrelated to any confidential interest attributable to him in connection with his former agency.

Under such circumstances there is nothing to substantiate a charge of fraudulent conduct based on breach of confidence or trust. There is no reason for holding that petitioner, after the severance of his relationship with the surety, could not negotiate freely for his own interest or act adversely to his former principal as fully as any other person. Robertson v. Chapman, 152 U. S. 673, l. c. 683; Dennison v. Aldrich, 114 Mo. App. 700, l. c. 709.

The advantage obtained by petitioner at the time of ob-

taining repayment of his loans was achieved simply by his prudence and exercise of vigilance, and not by reason of anything arising during his agency with the surety. In this connection no cause exists for depriving him of that advantage.

POINT E.

It is urged, finally, that the slur cast at petitioner as a purported additional reason for refusing allowance of his claim was totally unjustified and that this injustice should be reviewed and remedied. We refer to the District Court's finding that the claim of $10,405.65 filed by Martin as representing his account on the Carlinville contract included items advanced under the other contract, and its conclusion therefrom that he did not come into equity "with clean hands" (R. 48, par. E). Because it is felt that the charge of misrepresentation involved a lack of understanding of the facts, it is necessary that several portions of the record be referred to.

The basis of this "finding" was a deposition of Martin given in another case, wherein he had stated, in answer to a question as to why he had included in his "claim" in the National Surety Company case the item of $5,672 to cover bills on the Havana job, that: "I wanted to see them paid" (R. 142).

Both the question and answer, as well as the Court's conclusion therefrom, are patently based upon a misunderstanding as to the nature of the claim which had been filed by Martin and as to the evidence relating to the contractor's indebtedness to him. The items with respect to bills assumed and guaranteed by Martin on the Havana contract were clearly shown as such in the audited account which he himself caused to be prepared and placed in evidence (Martin's Exhibit N, R. 125). These were ex-

plained as constituting charges for "assumed bills" on the Havana job (R. 120), payment of which, by agreement with the Maryland Casualty Company, was to be made by Martin out of funds collected on that job (Martin's Exhibit M, R. 117). The account showing these items was not the basis of Martin's *claim*, however, and it was offered merely to give a statement of Tobin's account with Martin on *both* contracts more detailed and complete than the similar audit with respect to funds advanced on the Carlinville contract alone could give (Martin's Exhibit O, R. 125-127). In this separate audit report no charges were set up to cover any items other than those which, by the undisputed evidence, related only to the Carlinville financing. Martin's *claim*, filed pursuant to the Court's order, merely reflected this separate audit and was properly confined to Carlinville items (R. 34-38). Such claim did *not* include, and cannot be construed as attempting to include, any items involved in the other contract. The implication of misrepresentation in regard thereto was wholly unfounded, as shown above, and we repeat that the injustice committed should be corrected.

CONCLUSION.

At the expense of brevity, perhaps, a discussion of all points deemed material to a proper decision in the case has been undertaken. To accomplish this it was necessary to go beyond the single issue on the merits decided by the Court of Appeals. This was done that this Court might immediately be apprised of the several questions present, all of which petitioner is prepared to meet. It is earnestly hoped that this Court may see fit to consider a review of them all, that a troublesome litigation may thus be terminated.

In urging the several issues, however, it is not intended that the extreme importance of the single issue decided by the Court of Appeals be obscured. That question, it is respectfully urged, requires authoritative clarification. As the court below itself says (R. 162): "This is important to those furnishing labor and material for public works as well as those called upon to make loans to contractors to carry on such work."

As the matter stands on the decision below, neither such contractors nor those called upon to make such loans are left free to deal with any payments coming into their hands for completed work. If the announced doctrine be sound, then no title may be asserted or relied upon in any payment made at any time when bills remain unpaid, except one in recognition of superior rights of a thrice-protected class of creditors. That is the issue squarely presented by the decision here.

Petitioner most respectfully submits that this case, in view of the nature of that issue and of the manner of its determination, is one urgently calling for the issuance of a writ of certiorari and for a review and reversal of the decision of the Court of Appeals.

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